

MEMORANDUM

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SECRETARY, BOARD OF
OIL, GAS & MINING

To: Utah Board of Oil Gas and Mining

From: Steve Alder, 
Assistant Attorney General

Re: February 27, 2019 Board Hearing Memorandum

In the Matters of Request for Agency Action by Wesco Operating Inc. for an Order authorizing the drilling of the proposed CCU 7-2R2-26-20 Horizontal well in portions of Sections 4, 5, 7 and 8, T 2So, R20 E, SLM, Grand County, Utah.

Docket 2019-007, Cause No. 166-11

I. The Request.

This RAA proposes to use the exception location rule to have the Board authorize drilling a well diagonally across the boundaries of three sections and across the boundary between a federal unit and non-federal unit lands. The well is proposed to begin on lands that are in the Cane Creek Federal Unit (Sections 5, 7 and 8) and to extend the well to lands that are east of and outside of the federal unit (Section 4). The eastern extension of the well also passes within 460 feet of section 9. The lands in sections 4 and 9 to the east of the federal unit are unspaced. In addition, Sections 5 and 8 are in the Fourth Revision of the Second Consolidated Paradox Participating Area, while Section 7 lands are not in that participating area.

The Division previously advised Wesco that it could not approve an APD for the requested well as proposed under the authority of the exception location rule, despite having the consent of all owners with 460 feet of the well bore. The Division recommended Wesco ask the Board for designation of a drilling unit for the well or the drilling of a temporary spaced well in Section 4. The Division was clear that the Utah rules allow for exceptions for well location within a federal unit, but not for wells that extend outside of the federal unit.

Despite this prior advice, Wesco elected to proceed with the well at the location proposed and filed a sundry to deviate the well to the north when it reached the southern boundary of section 7 so it would remain in the federal unit. That well was not productive and was plugged back to the boundary with Section 7. Wesco now wishes to extend the well along the originally proposed well path into section 4 lands that remain outside of the federal unit.

Wesco, in a reversal of the usual tendency of operators, and contrary to the recommendation of the Division insists that it is premature to ask the Board to space the lands for the well. Wesco proposes that it first to be allowed to drill the well under an exception location and then it will apply for spacing or perhaps ask to expand the federal unit.

II. Analysis.

A. Use of the Exception Location Rule

The exception location rule allows for exceptions to the requirements that otherwise apply *within* a drilling unit or *within* an unspaced section. The exception location rule is not an independent basis for siting a well outside of a drilling unit or outside of a unspaced section - if you have consent of all owners within a distance of the well bore. The rule allows for exceptions to rules that otherwise apply. *Either lands are spaced and well locations are proscribed by the order, or lands are unspaced and the general well siting rules dictate permitted locations. The exceptions location rule applies to the limits of each.*

1. The General Well Siting Rules - R649-3-2, Parts 1 through 9.

The general well siting rules provide that for lands that have not been spaced ("in the absence of special orders of the board establishing drilling units") wells can be located as these rules allow. The rule expressly provides that horizontal wells to be located within federally supervised units are exempt from parts 5, 6, and 7 (R649-3-2 part 8), and expressly provides that exceptions to parts 3 through 7 (which address horizontal well locations) may be approved pursuant to the exception location rule R649-3-3 (R649-3-2 part 9). Although there is not an express statement to this effect in the rule, it is clear that the locations and set-backs it proscribes for well locations are described relative to the boundaries of a surveyed section. The locations allowed are locations within such a section.

2. The Exception Location Rule - R649-3-3.

The exception location rule allows for exceptions to the general well siting rule's location and set-back requirements, and also allows for exceptions to the well location requirements of an order establishing drilling units (Part 1). The rule allows for approval of an exception to the general well siting rule if the application includes written consent from all owners within 460-foot radius of the proposed well location (Part 1.2). For exceptions to the location requirements of a spacing order the rule requires obtaining the written consent of all owners of directly and diagonally offsetting drilling units (Part 1.3).

Part 2 of the exception location rule provides that "if for any reason the division shall fail or refuse to approve such an exception, the board may, after notice and hearing, grant an exception." This is the awkward way that the rule allows for the board hear and grant an exception location if the written consents as required cannot be obtained.

Normally if the operator cannot obtain the consent of all required owners, he will file a RAA for board approval of the exception location. However, by implications Part 2 also provides that the Division need not approve every location even when there is full consent, and that the Division may deny an application for other reasons. In such cases, such as this one, the board may review the application and the Division's reasons for denying the application at a hearing and grant or deny the request as it determines appropriate and consistent with the Act. (That is the status and purpose of this hearing. As is argued later in this brief, this essential oversight should *not* be eliminated by a declaratory order.)

3. Application of the Rules within the context of the Oil and Gas Conservation Act.

It is important not to lose sight of the core concept that the exception rule provides for an exception to the two well siting provisions in the law, which are stitched into the spacing and pooling provisions of the statute. This rule is not an independent basis for locating wells. If the exception location rule were to be cut free from its connection to the sectional limitation of the general well siting rule and the size and location limits of a drilling unit, the result would be chaos. The exception could devour the rules.

Detachment of the exception location rule from either use within sections or drilling units, would allow a well of any type to be drilled at any location so long as there was the needed consent of the owners. This use of the exception location rule could allow for operators to ignore the size limits on wells allowed by spacing orders subject only to getting consent of owners. It could allow an operator to ignore the attendant findings as to proper location of a pool, the mandated N-S or E-W direction for a horizontal well in a 640 or 1280 drilling unit, and other technically derived limits on setbacks.

4. Examination of the Application of the Exception Location Rule to the General Well Siting Rule.

The Petitions argument for use of the exception rule to authorize horizontal well locations to cross section boundaries outside of the drilling unit or section is that it is not expressly prohibited. But it is also not expressly allowed. It is not surprising that there was no express language addressing the possible drilling of horizontal wells outside of a section without spacing, since at the time the rules were adopted, horizontal wells were not common and were not usually of any great length.

The allowance in Part 9 of the General Well Siting Rule that exceptions to the horizontal well spacing limitations in Parts 3 through 7 may be approved upon application for an exception location, does not provide authority to use the exception location rule to allow horizontal wells to be located anywhere subject only to obtaining

the consent of the owners affected. The provision is unremarkable and hardly needed saying. It merely allows the exception location rule to apply to each provision.

An examination of how the exception location rule would apply to each of Parts 3 through 7 is instructive of the intent of Part 9.

Part 3 - An exception to Part 3 allows a horizontal well to be located closer than 660 feet to the drilling or spacing unit boundary. This makes sense when applied within the section of drilling unit. Granting an exception to this provision does not require the Division to approve a horizontal well location that traverses outside of the drilling unit boundary or across a section line without limit except obtaining the consent of the owners.

Part 4 - An exception to Part 4 hardly makes sense since is permissive.

Part 5 - An exception to Part 5 plainly allows a horizontal well to be closer than 1320 feet to a vertical well *in the section*; again, it does not make sense to take the exception to grant approval for a horizontal well to extend across a drilling unit or section boundary.

Part 6 - An exception to Part 6 is difficult to apply. Part 6 establishes a temporary sectional drilling unit. However, this is not a true drilling unit but a well density and location rule. (R6491-1 definition of temporary spacing unit). An exception to this rule would allow a temporary drilling unit of a different size or perhaps eliminate the requirement for one. The rule is mostly important as coupled with Part 7 which requires notice to owners in the temporary spacing unit.

Part 7 - An exception to Part 7 would allow drilling a horizontal well without having to give notice to the owners in the section which may have reasons, but again, it does not say the well can be approved if it goes outside of the section and if it did such an expansive grant without requiring notice would be contrary to the requirement to protect correlative rights.

In addition, Parts 6 and 7 of the rules which mandate sectional temporary spacing and sectional notice suggests that the writers of the rules assumed a horizontal well would be contained within a single government section not permitted even under the exception location rules to be drilled across drilling unit and sectional boundaries.

5. Comparison with Application of the Exception Location Rule to Drilling Units.

The exception location rule as written applies interchangeable to allow exceptions to well locations required by orders for a drilling unit and to well location required in an unspaced area by the general well siting rule. It is very clear that an exception location could not allow a well to be located outside of a spaced drilling unit or to cross a drilling unit boundary without also modifying the spacing order. Otherwise such an application would violate the basic assumptions of spacing; i.e., that the pool is to be produced by the well or wells permitted in the drilling unit with limits on set-backs and locations; and that the wells authorized by a spacing order are the proper number of wells required to efficiently produce the pool. To allow a well to both drain from lands in a drilling unit

and from lands outside of the drilling unit would obviously require modification of the drilling unit not approval of an exception location.

To take a different approach when considering exceptions to the general well siting rule for unspaced land is equally at odds with the assumptions of the Conservation Act. The general siting rule limits the size of an area that can have one well absent spacing. It assumes the locations allowed by the rule for vertical wells or horizontal wells allowed will be generally protective of correlative rights and avoid waste while promoting production. As with spaced drilling units, it would be improper to allow use of the exception locations rule to approve an extension of a horizontal well beyond the limits the general rule is based upon. The exception location rule does not require that result and the better reading it to treat a section as its analog drilling unit and apply the exceptions to locations within the section and not to locations proposed outside of the drilling unit. There is no basis for such extension, and it would proceed without limit and do havoc to the orderly development that spacing provides allows.

The goal of the Utah Oil and Gas Conservation Act is to fairly protect correlative rights and avoid waste. Spacing is the preferred way to control drilling and share production. The general siting rules *and allowed exceptions* are the approximate guidelines to be followed in the absence of spacing, but their use should not be expansive but limited. Hopefully the board will agree that the exception location rule is limited to permitting exceptions locations that are still within a drilling unit or section and not approve of free ranging use of the exception location rule.

6. Exceptions allowed by the General Siting Rules for Federal Units.

It is true that the oil and gas rules allow the authority to locate wells to be delegated to the federal land manager for federal units, but that is allowed for other reasons. Then, it is presumed that there is supervision by the federal agency in a manner that protects correlative rights and promotes development. It is an agreement that there be one, rather than two regulatory entities locating wells. The same cannot be said or allowed for unspaced lands. It is improper for the board to delegate such authority to locate wells to an operator for wells outside of a drilling unit or wells that extend outside of one section.

The general well siting rule and the attendant exception location rule are limited in scope to one section or one drilling unit in order to balance the granting of a limited degree of freedom to an operator against the board's need to establish uniform and organized spacing and siting of wells for pools and fields in a manner that promotes orderly development and protects correlative rights. Such a free use of the exception location rule is contrary to the promotion of orderly development, and the protection of correlative rights.

7. Denial of the Request for Declaratory Relief

If the Board were tempted, based on unusual facts, to grant an exception location for a well outside of the section or drilling unit as did it did in the KGH Operating Company request in Cause 179-018, Docket 2017-022, the Board can and should limit the precedent of the decision and impose reporting requirements as it did in that case. That is not what has been asked in this case. The 166-08 Cause approval of a *directional* well across a federal unit boundary is not similar to the two-section extension of a horizontal well across federal unit boundary as requested here and is not precedent for granting this RAA.

Rather, the relief requested in this RAA far exceeds such limits. The Petition asks for declaratory relief "clarifying and declaring for future horizontal well development that the Division has administrative authority to grant an exception location approval for a horizontal well which crossed a federal unit boundary" subject to the consent of all owners within a 460-foot radius of the proposed well bore.

Granting the Declaratory Relief would be a far greater extension of the rule and would remove the oversight that is required by the exception location rule itself. It would write out the discretion granted to the Division to deny an application for reasons other than lack of consent - reasons which the Division believes have been pointed out above. The exception location allows the Board to act, if the Division denies the request. There is good reason for such oversight. Directing the Division to grant an exception when there is full consent would be going a step too far. At the very least the Board should deny that part of the Request and limit the precedent, duration, and use of the exception approval to this one well.

B. Spacing for One Well.

Although it may be preferable not to space a well without more information as Wesco suggests, it is preferable to space for a well on an exploratory or pilot basis than it is to allow drilling the well under the exception location basis without spacing. Although in this case ownership of the minerals is the same both in and out of the federal unit, the sharing requirements inside of the unit are governed by the federal rules related to the Unit and the Participating Area. These requirements will be difficult to impose on owners outside of the federal unit and could affect the lands differently.

The portion of the well on the unspaced lands is free to drain lands without sharing on any basis except the lease basis for the well bore. And dividing production amount owners could be problematic if ownership changes. At the very least is a bad precedent to allow the drilling of a well across a federal unit, without spacing. In other instances this will create problems. Potentially sharing of production between the federal unit lands and federal non-unit lands will not be decided by the Board, as is appropriate, but left to the operator pursuant to federal agreements yet to be reached. Spacing will allow the board to designate or clarify the basis for sharing of production between the two types of lands. That will be left unresolved by the relief as requested.

C. Temporary Spacing of a New Well in Section 4

One other alternative would be to establish different drilling location and drill a horizontal well that is solely in Section 4. Drilling temporary spaced well in section 4 might provide the additional information for spacing of a longer horizontal well. This is the option that the general well siting rule sanctions. It is the option that has been used by operators in the Uinta Basin when first beginning their horizontal well program. It has the advantage of orderly development for the entire area and avoids the misuse of the exception location rule. It is too unfortunate that Wesco committed to this well, but they have yet to put forth any reason other than their mistaken assumptions and premature commitment why this location is necessary. It has numerous disadvantages including the diagonal layout. There are no faults or other geologic structures limiting a more regular development location which were in part the basis for the order in the KGH matter.

IV. Conclusion

The Exception Location Rule should not be used to approve the well location in this case. That rule should be limited to the purposes for which it was written and limited to the specific location limitations within drilling units or a section. If it is uncoupled from these two well siting tools, and given *carte blanche* it will result in a lack of consistency and board control over horizontal well locations. At the very least specific limitations should be placed on this well and declaratory relief should not be granted.

It is unfortunate that the well was originally proposed at a location that does not comply with the Utah's *de facto* system for developing unspaced lands. However, the Operator was advised of this fact prior to drilling and elected to drill a well and proceeded to put themselves in this situation. That lack of planning is not a good reason for the Division to deviate from the established rules and principals for orderly development of oil and gas production. If the board were to approve the request it would lose all control over development in unspaced lands.

The Board should allow the Operator to request spacing on a limited and pilot basis for the single well or direct it to proceed under the general well siting rules to drill a new well in section 4.